The great turnaround : How public sector banks became most profitable in India

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Public sector banks have rarely had it so good. The State Bank of India reported a jump in profit of 178 per cent in the first quarter of the current financial year. This now makes SBI the most profitable company in India, ahead of Reliance Industries. Other public sector banks have done similarly well. Together, their profits touched nearly Rs 35,000 crore, which is more than double the amount in the same period last year. And that is only in one quarter. For the full financial year 2022-23, public sector banks made profits of over Rs 1 lakh crore.

These numbers might surprise people who remember earlier this year, when the opposition protested in parliament and on the streets to “Save SBI.” Save SBI from what? Making record profits? They also said “Save LIC.” Well, in the first quarter of this year, profits at LIC are up 14 times! This comes on the back of an already brilliant performance in the financial year 2022-23, when there was a nine fold increase in profits over the year before that.

But it was not always like this. Let us go back for a moment to 2013-14. Everyone knew that public sector banks were sitting on bad loans, but hidden in accounting tricks. That this could happen under the watch of Dr. Manmohan Singh, an economist by training, was no less than shocking. The clamor could no longer be ignored. For the financial year ending in March 2014, the last one for the UPA government, public sector banks admitted to a sharp 27 per cent fall in ‘profits.’ But this was just the tip of the iceberg. It turns out there were likely no profits at all! Over the next several years, the bad loans would have to be dug out, slowly and painfully. The cumulative losses to state run banks would be over Rs 2 lakh crore.

But they left it as a task for the next government. This is the story of the great public sector bank turnaround after 2014. From cumulative losses of Rs 2 lakh crore, to profits of over Rs 1 lakh 70 thousand crore in just the last two years.

How bad were things in 2013?

It came out in stages, as the account books were opened and checked. After admitting to a 27 per cent fall in profits in 2013-14, public sector banks began to admit to actual losses over the next several years. Then in 2015, the government began a detailed investigation to find out the real amount of non-performing assets. This was known as an Asset Quality Review (AQR). The lowest point was 2017-18, when reported losses were over Rs 85,000 crore.

First of all, what is a non-performing asset, or NPA? A bank gives out loans, and collects interest on them. For a bank, a loan is actually an “asset,” because it gives a return every quarter. So if a bank lends money to someone who cannot pay in time, the loan becomes a non-performing asset. The bank is supposed to report these NPAs faithfully to the RBI, the shareholders and the public. But there are many ways to hide this information. The bank could just keep quiet. Some tricks are even worse. A bank could just give the defaulter a new loan, which would be used to pay back the old loan. And that is how an old bad loan turns into a new 'good' loan, almost by magic. To spot all such tricks, we needed the Asset Quality Review, which began in 2015.

So what were the results of this review? Absolutely terrifying. For banks, any level of NPAs above 3-5 per cent is considered dangerous. But Canara Bank had an NPA level of nearly 12 per cent, Bank of Maharashtra 19 per cent, and Punjab National Bank 18 per cent. For banks such as IDBI, or UCO Bank, or Indian Overseas Bank, the NPAs were in the range of 24-28 per cent! For SBI, the largest lender of all, it was already at almost 11 per cent. Taken together, NPAs of India's public sector banks had reached 15 per cent, many times above the danger level of 3-5 per cent.

The situation was so critical that the RBI decided to put 11 out of 21 public sector banks – more than half - under its special Prompt Corrective Action (PCA) framework. It is as bad as it sounds. Imagine if your doctor told you that you need "prompt corrective action" to save your health. Would you be scared? Well, you should be. Now what could have happened if these NPAs had remained hidden? Sooner or later, they would have brought down our economy.

What is the current situation of public sector banks in 2023?

All the 11 banks which used to be in the RBI's Prompt Corrective Action list have come out of it. The last of these banks was released in September of 2022, and the list became empty. Now every public sector bank is making a profit. Leading the way is State Bank of India with 178 per cent profit growth in the first quarter of the financial year. Then, there is Bank of Baroda with 88 per cent, Canara Bank with 75 per cent, and Punjab National Bank with 307 per cent. From Rs 66,000 crore in fiscal year 2021-22, profits of public sector banks rose to Rs 1.04 lakh crore in the fiscal year 2022-23. With an additional Rs 35,000 crore in profits in just the first quarter of the current financial year, the stage is set for another record breaking performance.

What about those pesky NPAs? At the same time, non-performing assets (NPAs) of public sector banks have fallen to only around 5 per cent. Also, in the last 9 years, Indian banks have managed to recover more than Rs 10 lakh crore from loans that had gone bad. Can you imagine what would have happened to our economy if these 11 public sector banks had not been saved?

But why did public sector banks give so many bad loans?

Former RBI governor Raghuram Rajan explained this in his reply to the parliamentary panel in 2018. "*A larger number of the bad loans originated in the period of 2006-08*," he wrote. At this time, hopes were running high. And the banks did not put a lot of thought into lending decisions. Rajan also mentions an incident that one company owner told him about. Back in the day, banks would chase him with checkbooks, willing to lend almost any amount.

And it is not easy to get rid of bad loans, even years later. Rajan also explains why NPAs continued to grow in the first few years after 2014. "*As NPAs age, they require more provisioning*," he said, "*So* *projects that have not been revived simply add to the stock of gross NPAs. A fair amount of the increase in NPAs may be due to aging rather than as a result of a fresh lot of NPAs*."

We have to ask the obvious question here. Were these bad loans given under political pressure? Raghuram Rajan never gave a straight answer. But in his 2018 response to parliament he says something that we believe makes the situation quite clear. "*Too many loans were made to well-connected promoters who have a history of defaulting on their loans*," he wrote. Well-connected? Okay, we understand. Incidentally, in December 2013, then finance minister P Chidambaram insisted that you cannot blame the government if public sector banks have made bad loans. "*Blame should stop with the bank boards and not with the government*," he said. Sure Mr. Chidambaram, if you say so.

How did the government turn around public sector banks after 2014?

The first step was to put new money into the public sector banks. This was called recapitalization. This would build confidence in the ability of those banks to stay afloat. Over Rs 3 lakh crore was injected into the system. Most of the money came from government bonds. This process got over last year. There was no need for further recapitalization in the budget for the current year, because the banks were seen as fully stable. Another way was to merge groups of weak banks with strong 'anchor' banks. This would save on some costs, improve efficiency, and dilute the problems of weaker banks. But you can imagine the dangers. The contagion from the bad banks could have spread to the good banks. It had to be managed carefully. And it worked.

Then, there was the Insolvency and Bankruptcy code. It gave a clear legal framework for banks to collect from defaulters. And for companies to close down bad businesses. Taken together, the banks collected over Rs 10 lakh crore from non-performing assets since 2014. And finally there was the whip. No longer could anyone take new loans to pay back old ones. Wilful defaulters could not start new businesses. They were not even allowed to raise money from stock markets.

But what about those write-offs?

By now, you must have heard about them. If you so much as utter the word 'bank' on social media, you will face trolls asking why lakhs of crores of bad loans were 'forgiven.' Except they were not. A write off is not a loan waiver. A write off is simply an accounting term. It admits that a loan has gone bad, maybe years ago. Previously, banks did not want to admit that. They kept counting bad loans, or non-performing assets, as real assets. That is what the problem was. That is why the government and the RBI had to open up and check their account books. You cannot blame the dentist for pulling out your bad tooth.

But for many prominent bad faith actors and their social media followers, it is easy enough to confuse the public over what accounting terms mean. Ironically, many of these bad faith actors are prominent members of the old establishment. The old establishment which gave these bad loans, and refused to take responsibility for them.

These banks were created by our nation's pioneers, we hold them in trust

In 1906, Ammembal Subba Rao Pai created the Canara Hindu Permanent Fund, which we now know as Canara Bank. He was a nationalist and an educationist who set up several schools, including one for girls. Indeed, each of our public sector banks has a story of entrepreneurship behind it. Punjab National

Bank was created by leaders such as Lala Harkishen Lal, and inspired by Lala Lajpat Rai. Lala Harkishen Lal went on to build factories and insurance companies in the early 1900s, as well as the organization that eventually became FICCI.

So these banks were built by pioneers, often against heavy odds created by British colonial rule. They were created by people who understood that India would be free one day, and would need its own institutions. Even in those days, these banks would trade as far as Japan, Singapore and Africa. These banks also embody the spirit of our country. One of the founders of the Bank of India was Sassoon David, a Baghdadi Jew who fled persecution in the Middle East. We have to remember that the Nehruvian socialist command economy of the 1950s and 1960s did not build these banks. It simply took over them in 1969. Atal Behari Vajpayee, then a young MP, had called the move *ashobhaniya*, *anuchit*, *akaaran* and *anavashyak*.

Anyway, that was a long time ago. The point is that those who let these banks be buried under bad loans were at fault. They had no right to destroy that which they did not build. Today we hold these banks in trust, for our pioneering entrepreneurs, and for future generations of the Indian people.

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